

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Pescetti Analyst: Kristina E. North Bill Number: AB 1625

Related Bills: See Legislative History Telephone: 845-6978 Amended Date: January 7, 2002

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Public School Extracurricular Activity Fees Credit/Donation to Charitable Organizations for Private School Scholarships to Low-Income Children Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

X FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED FEBRUARY 23, 2001, STILL APPLIES.

X OTHER - See comments below.

## SUMMARY

This bill would create two credits related to education:

- ◆ A credit for contributions to a public school to support its extracurricular activities; and
- ◆ A credit for donations to a nonprofit charitable organization that provides private school scholarships to low-income, handicapped children.

## SUMMARY OF AMENDMENTS

The amendments made significant changes to the provision relating to the credit for donations to school tuition organizations and added the extracurricular activities credit discussed in this analysis.

The amendments resolved the implementation considerations discussed in the department's analysis of the bill as introduced February 23, 2001, relating to defining the phrases "amounts donated," "nonprofit charitable organization," and "private school." As a result of the January 7, 2002, amendments, new implementation considerations are included below. The remainder of the department's analysis of the bill as introduced February 23, 2001, still applies.

Board Position:

<u>      </u> S	<u>      </u> NA	<u>      </u> NP
<u>      </u> SA	<u>      </u> O	<u>      </u> NAR
<u>      </u> N	<u>      </u> OUA	<u>  X  </u> PENDING

Department Director

Date

Gerald H. Goldberg

02/19/02

## **PURPOSE OF THE BILL**

According to the author's office, the purpose of this bill is to:

- ◆ Encourage support for public school extracurricular activities; and
- ◆ Give low-income children an opportunity to attend private schools by encouraging taxpayers to make donations to nonprofit charitable organizations that provide private school scholarships.

## **EFFECTIVE/OPERATIVE DATE**

This bill is a tax levy and would be effective immediately upon enactment. These credits would apply to contributions made in taxable years beginning on or after January 1, 2002.

## **POSITION**

Pending.

### **Summary of Suggested Amendments**

Department staff is available to assist the author in resolving the implementation and policy considerations discussed below.

## **ANALYSIS**

### ***Extracurricular Activities Credit***

#### **THIS BILL**

This bill would:

- ◆ Create a 100% credit applied against 50% of the taxpayer's tax liability for contributions made by the taxpayer to a California public school for support of the school's extracurricular activities.
- ◆ Define "extracurricular activities" as school sponsored events or activities that require a fee to be paid by an enrolled student to participate.
- ◆ Limit the credit to contributions not designated by the taxpayer for the benefit of a specific student or his or her dependent.
- ◆ Allow any credit that exceeds the taxpayer's tax liability to be carried over and used in the following six years.
- ◆ Require each recipient school to provide the taxpayer with a receipt.
- ◆ Require the school to make available to the public an annual report on the total amount of contributions and their use.

- ◆ Clarify that the contributions made under this bill are meant to augment rather than replace any existing public funding for extracurricular activities.

### IMPLEMENTATION CONSIDERATIONS

The department has identified the following concerns:

- ◆ This bill would allow a 100% credit for any fees or cash contributions, limited to 50% of the taxpayer's net tax liability. This is an unusual calculation that would require a new form or worksheet, thus increasing the complexity and cost of the tax form.
- ◆ No ordering or other priority rules for calculating the credit are provided. Thus, it is impossible to determine whether a taxpayer would get 50% of net tax BEFORE application of other credits, or AFTER application of other credits. The same language being used in BOTH credits under this bill further complicates this situation, as the bill does not specify which should be applied first. Without clarification, this provision may cause disputes between the taxpayers and the department and be difficult to administer. The author may wish to change the credit to a simple 50% of the fees or cash contributions paid or incurred, which could be included on the normal tax return, simplifying the process for taxpayers and saving departmental costs.
- ◆ To verify that the donation meets the credit requirements, it would be helpful if the recipient school were required to include the following information on the receipt:
  - (1) The school's name;
  - (2) The taxpayer's name;
  - (3) The date and amount of donation;
  - (4) A statement that the money will be used for the school's extracurricular activities; and
  - (5) A statement that the taxpayer did not designate that the money be used for a specific student or a dependent of the taxpayer.

The bill should require the taxpayer to provide the receipt upon the department's request.

- ◆ Since "public school" is not defined, it could be interpreted to include all public schools ranging from elementary school to college. It would be helpful if the bill were amended to clarify the author's intent.

***Low-Income, Handicapped Children Tuition Credit***

**THIS BILL**

This bill would:

- ◆ Create a 100% credit to be applied against 50% of the taxpayer's tax liability for cash contributions to a school tuition organization that provides K-12 school scholarships to low-income, handicapped children.
- ◆ Define:
  - (1) "School tuition organization" which must:
    - (a) Be a charitable organization exempt under federal tax law.
    - (b) Allocate at least 90% of its annual revenue for educational scholarships or tuition grants to children whose family income does not exceed 2.5 times the federal poverty level. If too few eligible students qualify for scholarships, then any remaining amount necessary to meet the 90% allocation requirement may be rolled over into the following year and subsequent years until the annual revenues are completely allocated.
    - (c) Allow the parents of the student to choose any qualified school.
    - (d) Not limit the availability of the scholarships or tuition grants to only students of one school.
  - (2) "Qualified school" which must:
    - (a) Be a non-governmental California preschool, elementary or secondary school, or any combination thereof;
    - (b) Be for handicapped students;
    - (c) Not discriminate on the basis of race, color, handicap, familial status, or national origin; and
    - (d) Satisfy the requirements prescribed by law for California private schools on January 1, 2001.
  - (3) "Handicapped student" as a student with a hearing impairment, visual impairment, preschool delay, or speech or language impairment.
- ◆ Limit the credit to contributions not designated by the taxpayer for the benefit of a specific student or his or her dependent.
- ◆ Allow any credit that exceeds the taxpayer's tax liability to be carried over and used in the following six years.

- ◆ Require each recipient school tuition organization to provide the taxpayer with a receipt.
- ◆ Require the school tuition organization to make available to the public an annual report on the total amount of contributions and their use.
- ◆ Clarify that the contributions made under this bill are meant to augment rather than replace any existing public funding for scholarships.

#### IMPLEMENTATION CONSIDERATIONS

The department has identified the following concerns:

- ◆ This bill would allow a 100% credit for any fees or cash contributions, limited to 50% of the taxpayer's net tax liability. This is an unusual calculation that would require a new form or worksheet, thus increasing the complexity and cost of the tax form.
- ◆ No ordering or other priority rules for calculating the credit are provided. Thus, it is impossible to determine whether a taxpayer would get 50% of net tax BEFORE application of other credits, or AFTER application of other credits. The same language being used in BOTH credits under this bill further complicates this situation, as the bill does not specify which should be applied first. Without clarification, this provision may cause disputes between the taxpayers and the department and be difficult to administer. The author may wish to change the credit to a simple 50% of the fees or cash contributions paid or incurred, which could be included on the normal tax return, simplifying the process for taxpayers and saving departmental costs.
- ◆ The definitions need clarification. For example, under "school tuition organization," the organization is required to give scholarships to individual children from low-income families. However, the "qualified school" must be a school "for handicapped children." It is unclear whether this means the student population must contain only handicapped children or whether a scholarship can be provided to any child from a low-income family that attends a school at which some handicapped children are present.
- ◆ The department does not have the expertise to determine what constitutes a hearing impairment, visual impairment, preschool delay, or speech or language impairment. It would be helpful if another entity with the necessary expertise is required to certify that the individual student or students receiving the scholarship at the school meet the specified criteria.
- ◆ To verify that the donation meets the credit requirements, the department would need the receipt to include:
  - (1) The school's name;
  - (2) The taxpayer's name;
  - (3) The date and amount of donation;

(4) A statement that the taxpayer did not designate that the money be used for a specific student or a dependent of the taxpayer; and

(5) That the student and school met the criteria of being handicapped or teaching the handicapped.

The taxpayer should be required to provide the receipt upon the department's request. Without this information, the department would not be able to verify that the credit requirements have been met.

- ◆ The author may wish to consider changing the requirement that the school tuition organization allow the student to attend any qualified school of “their parents’ choice” to “their parents’ or guardian’s choice” in the event the student is not in the care of one or both of his or her parents. Additionally, in the event that the student is in the care or custody of one parent, it is not clear if both parents must agree on which school the student should attend.
- ◆ The requirement that the school tuition organization must allocate at least 90% of its annual revenue to low income, handicapped children for educational scholarships or tuition grants would be impossible to audit. The bill allows the 90% allocation criteria to be deferred indefinitely. Therefore, an organization would never have to meet this criteria.
- ◆ This bill requires that the school tuition organization provide educational scholarships or tuition grants without limiting availability to only students of one school. It is unclear how the department would verify this requirement.

### TECHNICAL CONSIDERATION

This bill uses the phrase “educational scholarships or tuition grants” and the term “scholarship” as if interchangeable throughout the bill. Additionally, the terms “students” and “children” appear to be used interchangeably. To reduce potential confusion, the author may wish to use consistent terms throughout the bill.

### **OTHER STATES’ INFORMATION**

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* found no comparable tax credits. These states were reviewed because of similarities to California income tax law or population.

### **FISCAL IMPACT**

This bill would establish a calculation for each of the credits that would require a new form to be developed. As a result, this bill would impact the department’s printing, processing, and storage costs for processing tax returns. The additional costs have not been fully developed, but could be significant.

## ECONOMIC IMPACT

### Revenue Estimate

Revenue losses from this bill are projected to be in the following orders of magnitude:

Estimated Revenue Impact of AB 1625 As Amended January 7, 2002 Enactment Assumed After 6/30/02 (\$ In Millions)			
Fiscal Years	2002/2003	2003/2004	2004/2005
A) Extracurricular Activities Cr.	-\$445	-\$485	-\$565
B) Handicapped Children Tuition Cr.	-\$240	-\$265	-\$305
T O T A L (Rounded)	<b>-\$685</b>	<b>-\$750</b>	<b>-\$870</b>

Any possible changes in employment, personal income, or gross state product that might result from this proposal are not taken into account.

### Revenue Discussion

Revenue losses would be determined by the number of taxpayers making payments to any public California school for extracurricular activities and/or cash contributions during a taxable year to any school tuition organization to allow low-income, handicapped children to attend nongovernmental K-12 schools in this state.

This bill would permit taxpayers to greatly reduce their state tax liability dollar-for-dollar (up to half of their tax liabilities) on contributions made for the specified purposes. Many taxpayers will redirect cash contributions normally made and claimed as deductions to take advantage of these credits. Other taxpayers will start making contributions.

#### Extracurricular Activities Credit

According to data from the California Department of Education, the enrollment in all California public schools was over 8 million during the school year 1999/2000. To estimate the magnitude of potential revenue losses, it was assumed that 5% of students (gradually growing to 7% in the 2004/2005 year) would have the equivalent number of taxpayers making payments of \$1,000 (on average) during the school year for students' participation in qualified extracurricular activities. The number of contributors was grown annually by public school enrollment growth rates.

#### Handicapped Children Tuition Credit

According to Franchise Tax Board data, the total number of cash contributors (individuals and businesses) was over 4.3 million for tax year 1998.

It was assumed that the number of taxpayers claiming this credit would be equal to 5% of existing contributors during the first taxable year (and gradually growing to 7% in the 2004/2005 and subsequent years thereafter) contributing \$1,000 per taxable year on average.

The deduction offset was also considered in both credit projections. It was assumed that 75% of credit claimants would redirect their normal contributions to receive enhanced tax benefits.

### **ARGUMENTS/POLICY CONCERNS**

This bill does not contain a sunset date for either credit. Sunset dates generally are provided to allow periodic review by the Legislature.

Credits generally are provided as a percentage of actual amounts contributed or paid. This bill would allow credits of 100% of the amount contributed, which is unprecedented.

Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible. Generally contributions to public schools and charitable organizations are deductible. This bill would have the effect of providing a double benefit by creating a credit and allowing the full amount to be deducted.

### **LEGISLATIVE STAFF CONTACT**

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